

1 we find that for example, 40 percent of the revenues -- CCLC
2 revenues generated just by our residential come from 10
3 percent of the customers.

4 What's that translates into is that we've got
5 customers that are paying nothing because they make no toll
6 calls towards the contribution of those costs. And we've
7 got others that pay as much as \$40 and \$50 a month. Now,
8 people paying \$40 and \$50, if you're a smart competitor in a
9 market, and there are smart competitors out there, figure
10 out that if you can buy an unbundled loop for \$20 to \$25 and
11 pull off to \$40 to \$45 in CCLC revenues, that's a pretty
12 good start in the marketplace.

13 That's the type of arbitrage that we have set up
14 through the permanent recovery of the non-traffic sensitive
15 costs. Eventually, those costs have to be borne in a non-
16 traffic sensitive manner, and indeed, they have to be borne
17 by the customer who causes those costs to be created by
18 subscribing to the network.

19 MS. HOGERTY: That is the position you're in right
20 now, deciding how you want to recover any of your costs as
21 an interexchange carrier, but that's a different question as
22 to whether the universal service fund should be collected
23 and distributed to interexchange carriers to do with
24 whatever they wish, as opposed to targeting high cost areas
25 to insure that rates are affordable.

1 MR. SICHTER: The subsidy that flows to the high
2 cost areas today is via the mechanism of the interstate as
3 well as intrastate subsidies such as the CCLC, and that's
4 what we are trying to replace. We're not trying to create
5 new money. We're trying to more specifically, identify how
6 a cost area --

7 MS. HOGERTY: Since you have stated that the loop
8 is required to provide your service, I don't think that you
9 can demonstrate a subsidy. I think all this deals with is a
10 question of how you're going to allocate a joint and common
11 cost. And I think we do need to pay attention to the
12 statute that says joint and common costs must be reasonably
13 allocated between universal service and other services.

14 MR. SICHTER: You can allocate the costs all you
15 want, but they have to come back on the consumer's bill.
16 Now, if you want to do it through a local service charge and
17 pix and a SLC, we can divide it up and put it back on the
18 bill. But when the dust settles on this, if it costs \$20 to
19 provide a loop to a customer, you either get that \$20 from
20 the customer or you get it from somebody else. If you get
21 it from somebody else, you've got a cross-subsidy problem.

22 MS. HOGERTY: Joel?

23 MR. SHIFFMAN: For many ways I've listened to this
24 argument, I find the discussion of differences of position
25 between Mr. Sichter, Sprint, GTE and Bell-South, and myself,

1 to be somewhat more semantic than substantive. And your
2 question, I think, raised that point very well. And that is
3 that, we -- I, personally, have no objection to removing
4 from the common line charge and the pixie those costs and
5 replacing them with a surcharge on carrier revenues. But
6 that's access reform. That's something that may be
7 desirable and is to be looked at as access reform. It's not
8 universal service reform. And your question raised that.

9 Universal service reform is providing funds, as
10 Mr. Lubin suggested, to make rates comparable, to make rates
11 affordable. And that there are different things that --
12 don't object to what you are doing Mr. Sichter, but it's not
13 -- but it is not -- it doesn't come under the rubric of
14 Section 254 or universal service. It probably is a
15 desirable objective. You can't continue to sustain per
16 minute recovery of costs that are not incurred on a per
17 minute basis.

18 I don't disagree with you, but call it for what it
19 is, a spade a spade. Access reform hasn't got far enough,
20 and access reform needs to be -- go further to recover those
21 costs in a way that will not distort the marketplace. But
22 don't call it universal service reform and don't make -- and
23 don't cheap out on universal service reform because you need
24 both of them. Fund both of them.

25 MR. SICHTER: You misunderstand. We either

1 move -- have to move those costs back to the end user, which
2 I'm hearing you agree with in terms of a flat rate charge,
3 or we're going to have to fund them through universal
4 service. And we need to get it out of the carrier charge.

5 MR. SHIFFMAN: You need to pull it out of the
6 carrier charge and either move them back to the end user
7 through a surcharge on carriers, not dependent upon use or
8 through an end user charge. But that doesn't make that a
9 universal service fund issue.

10 MR. SICHTER: It makes it a rate rebalancing
11 issue, which is exactly the right answer.

12 MR. SHIFFMAN: It is a rate rebalancing issue, but
13 --

14 MR. SICHTER: And that's fine. I said at the
15 opening, that the universal service subsidy implicit as well
16 as explicit we have today is huge. And the only way to
17 reduce it is rate rebalancing, which we are in favor of.
18 So, I mean, that's fine. That's --

19 MR. SHIFFMAN: But those are not new dollars as
20 you said.

21 MR. SICHTER: Absolutely. There aren't any new
22 dollars, Joel. We're shuffling existing dollars. We don't
23 need new dollars. We don't need bills to go up in
24 aggregate. We need to reshuffle the dollars we have today.

25 MS. HOGERTY: Can I ask another question? This

1 \$200, that -- do I understand it to be the current high cost
2 distribution to the large -- the non-rural companies? Is
3 that correct?

4 MR. WELLER: \$200 million.

5 MS. HOGERTY: \$200 million. What'd I say? \$200?
6 Okay. What is the 110 that you are referring to in your
7 statement?

8 MR. LUBIN: The number I was referring to was
9 there's \$110 million for what we call major LEC's. These
10 would be the RBOC's plus GTE and SNET. That is \$100 million
11 that goes to that classification.

12 Then, there's another classification which is
13 their -- we view as their non-major, but there also non-
14 rural. That number that we estimate, it's about \$230
15 million. So, we believe that the high cost -- well, I'll
16 say it this way. The high cost plus LTS and DEM for that
17 group, meaning non-rural, is approximately \$330, \$340
18 million.

19 So, again, it's \$110 million for the major LEC's.
20 Those are the top, say, GTE, SNET and the RBOC. It's \$110
21 million, \$230 is the next rung down of non-rural. And the
22 total, if you added it all up in terms of what happened on
23 January 1, 1998, is about \$1.72 billion.

24 Am I confusing?

25 MS. HOGERTY: Well, I'm familiar with -- I was

1 just trying to compare the 200 and your 110.

2 MR. LUBIN: Okay. My 110 is purely the amount for
3 major LEC's, the top seven companies. The next rung, which
4 is non-rural but not major is 230. That's our estimate.

5 CHAIRMAN KENNARD: Mr. Lubin, could I just get a
6 point of information for the record? How many basic
7 schedule customers does AT&T have? Roughly, ball park?

8 MR. LUBIN: I mean, offhand, I don't know that
9 number. I'm sure we would be glad to find that and give it
10 to you. I'm not sure I would want to publicly state that to
11 the world.

12 CHAIRMAN KENNARD: Do you know what the churn rate
13 is, in general, for your basic schedule customers? That is,
14 how many times they switch carriers?

15 MR. LUBIN: No. I know what the aggregate
16 estimate is for the industry. The last I heard it was about
17 50 million for the industry.

18 COMMISSIONER TRISTANI: How many?

19 MR. LUBIN: Fifty million.

20 CHAIRMAN KENNARD: I'm talking about for your
21 lowest volume consumers, your basic schedules what I'm
22 interested in. You don't know that?

23 MR. LUBIN: Don't know that.

24 COMMISSIONER TRISTANI: That's 50 million total
25 for all the industry.

1 MR. LUBIN: Yes. All the industry, the IXC
2 industry. That was the last number that I was familiar
3 with.

4 CHAIRMAN KENNARD: Okay. I think we're going to
5 have to wrap up soon. Commissioner Tristani, did you have
6 further questions?

7 COMMISSIONER TRISTANI: No, I'd like to give this
8 opportunity to the state commissioners if they have
9 something to add or to discuss?

10 CHAIRMAN KENNARD: That's a good idea. Any other
11 questions from the bench? Okay.

12 I just had a couple of questions really in the
13 nature of sort of housekeeping questions as we proceed from
14 here. We've talked about the process for proceeding from
15 this point. And I have talked about discussing with members
16 of the Joint Board the possibility of a referral to the
17 Joint Board if we can agree on the scope of the referral and
18 the timing. And if we are to take a referral of some of
19 these issues to the Joint Board, it will implicate our
20 schedule for resolving this matter.

21 I'd like to ask Mr. Weller from GTE if GTE would
22 be amenable to pushing off the January 1 deadline to afford
23 us more opportunity to get input from state members of the
24 Joint Board.

25 MR. WELLER: Mr. Chairman, I appreciate the

1 dilemma here because you want to get input and yet on the
2 other hand, we're all concerned about delay, because we
3 realize the importance of moving ahead with the program.
4 I'd answer the question, I think, by drawing a distinction
5 among the different purposes of the Federal fund or the
6 different objectives for the Federal fund. But I think
7 several have talked about -- Mr. Bush, I think is listed, a
8 similar set of objectives.

9 To my mind, the biggest single source of funding
10 that the Federal fund has to deal with is the implicit
11 support that is coming today from interstate access. And I
12 don't believe that you need -- that the FCC needs to refer
13 questions about the magnitude of that funding source to the
14 Joint Board. It's really about rates that are within your
15 jurisdiction. And I think that it should be possible to
16 arrive at a component of the fund that deals with that
17 problem by the end of the year.

18 Similarly, I think we all know what the current
19 amount is that's in the high cost fund today. So, we don't
20 really need to ask questions about that. We know what those
21 dollars are.

22 The third item that I've talked about is the
23 amount that would -- of new funding over and above the
24 current high cost fund that would be sent to the states to
25 deal with states with high cost and/or low funding basis.

1 There, I recognize that there are different interests of
2 different states around the table and that some Joint Board
3 activity must be a way at arriving at some reasonable
4 balance among these considerations.

5 So, if we were to consider a delay, I would
6 suggest that it would apply only to that portion of the
7 funding. In other words, you could adopt a fund that
8 addresses most of the funding that the Federal fund needs to
9 supply by the end of the year, and either defer that third
10 item or put some sort of plug in place to say, basically,
11 "Look, we're doing this much now. We'll refer that amount
12 to if we want it to be more or less. Give us input back
13 again."

14 So, I think that a referral might be a useful
15 process. I understand the problem with scheduling. But I
16 think we ought to craft it so that it does the least
17 possible harm in terms of delay of implementation to the
18 fund.

19 CHAIRMAN KENNARD: Mr. Brown, would you like to
20 address that point?

21 MR. BROWN: Yes, Mr. Chairman. I spoke at the
22 beginning about 200,000 customers that we serve that cost
23 over \$100 a month. These are the most vulnerable customers
24 in the system, another half a million that are over \$50.
25 And competition is here in the business markets where we get

1 most of the support.

2 I go back to what Chairman Wood said earlier about
3 we do not have to have the perfect solution initially. And
4 I'm not sure that we want the perfect solution to be the
5 enemy of moving in the right direction.

6 If -- I would make a couple suggestions to the
7 Commission as perhaps a way to move this along. One would
8 be there's been a lot of debate on the cost models. There's
9 probably going to be more debate about the cost models, but
10 both models indicate that there are a number of very high
11 cost customers that are going to need, under any system that
12 we come down with, support.

13 The second suggestion I would make is maybe you
14 address that high end first. You set the high end benchmark
15 high enough that you built a safety net under those
16 customers. And knowing that you've not solved the whole
17 problem there, but that as you refine the models as they
18 become more precise, as you find where the affordability or
19 revenue or whatever benchmark is going to be firmly be put
20 in place on the low end, you at least have begun to address,
21 you know -- what I hear, you know, coming out of a number of
22 the Congressional representatives from the area we serve,
23 that we've just got to get moving to make sure that we don't
24 lose this important thing we have of universal service.

25 So, my suggestion would be we find an interim cut

1 of the models. Maybe the staff common inputs. Maybe that's
2 a starting point. We find a high level benchmark that
3 addresses the needs of the states that face the most
4 difficult problem, and then work on fine tuning the low end
5 funding benchmark.

6 That would be my suggestion.

7 COMMISSIONER NESS: If your concern is the loss of
8 some of the business customers, wouldn't that be a function
9 of the intrastate implicit subsidy? That is, the difference
10 between business and residential or some of the other
11 elements that go in there, rather than on the interstate
12 side of the coin?

13 MR. BROWN: Well, Commissioner Ness, these are --
14 the states that are, you know, we've identified through the
15 modeling processes are the ones that have a lot of the very
16 high cost customers and don't have, you know, the large
17 concentrations of low cost customers.

18 COMMISSIONER NESS: Okay. But I thought your
19 concern had been that you're losing your business customers
20 to competition, and therefore --

21 MR. BROWN: And we're losing that implicit subsidy
22 within that state, and we can't wrap the state subsidy up,
23 or if we did, you get the kind of relationships we're
24 showing here, where in Commissioner Schoenfelder's state,
25 you've got a disproportionate --

1 COMMISSIONER NESS: Is it your testimony that a
2 six month delay would be extraordinarily detrimental? That
3 these people would -- that your highest cost customers would
4 fall off of your system? Are you suggesting that we would
5 lose them as participants in our telephone system?

6 MR. BROWN: I'm suggesting that we started
7 draining out the implicit support back in August of '96 --

8 COMMISSIONER NESS: But I'm asking you, if we were
9 to delay from January -- the implementation date from
10 January 1, to say, July 1, a six month period of time, in
11 order to give all of us, and we have right now 60 percent of
12 the Joint Board is new, or actually, not even the Joint
13 Board. Sixty percent of the folks here did not participate
14 in the prior decisions. Okay?

15 MR. BROWN: Yes.

16 COMMISSIONER NESS: Would it not make sense for us
17 to take that extra six month period of time and get it
18 right, rather than try to do something piecemeal in order to
19 make a January 1 deadline? Or is it such that if we delay
20 by six months in implementing this, that there would be a
21 whole bunch of folks in U.S. West territory that would fall
22 off the face of telephony? Is that your testimony?

23 MR. BROWN: I'm not prophesying the end of the
24 world. However, I think beginning to address the problem
25 this January, even though it's a B minus or even maybe a B

1 solution to take care of the most needy customers is
2 something that in six months, if the industry and the state
3 and Federal regulators roll their sleeves up, we can make a
4 good start at.

5 I would hate to see that date go by. I under your
6 reasons for wanting to do a complete thing, but I'm --

7 COMMISSIONER NESS: So, in other words, we should
8 put into effect some pieces of it, than begin to change
9 those pieces. Don't you think that would result in a lot of
10 confusion in the marketplace?

11 MR. BROWN: What I'm saying is take the high end
12 where there's absolutely no question that these are
13 customers that will need explicit support and begin
14 providing that.

15 COMMISSIONER NESS: Mr. Shiffman?

16 MR. SHIFFMAN: Yes. I'm very concerned that we use
17 even in the high end from the -- as suggested by Mr. Brown,
18 because of the fact that we still don't believe that the
19 models are reliable yet. And we believe that moving forward
20 on something that relies on those models, even taking the
21 high ends of those models, there's some demonstrated
22 reliability of the models would be premature.

23 At the same time, we believe -- I tend to agree
24 with Mr. Brown that there are certain problems with the
25 existing high cost fund.

1 And what we would ask that, it may be appropriate
2 to let the Joint Board look at these issues. It may be
3 appropriate to wait until the models are more reliable. But
4 at the same time, where we know that the existing plan has
5 certain deficiencies that are inconsistent -- that are
6 discriminatory towards some outlying jurisdictions, that it
7 may be -- that we would ask if you consider delaying the
8 program, to perhaps put in place an interim fix to take care
9 of these existing demonstrated anomalies in the existing
10 high --

11 COMMISSIONER NESS: So, in other words, we would
12 place -- work to put in place a regime -- go through the
13 regulatory process of putting in place a regime for January
14 that we would then change in July. Is that your
15 recommendation?

16 MR. SHIFFMAN: No. What I'm suggesting is you
17 modify what's in place, minimally, to take care of the
18 manifest problems with it. So, you don't put -- don't start
19 from anew. Start with the existing high cost fund program.
20 Make very, very minor changes with minimal as possible
21 around the edges to building on the existing program before
22 you move forward with something that replaces the whole
23 thing.

24 COMMISSIONER NESS: Ms. Baldwin?

25 MS. BALDWIN: I simply don't think there's enough

1 evidence to suggest that universal service is the least bit
2 jeopardized. And I don't think that there's -- I think it
3 would be a big mistake to rush forward on such a complicated
4 issue and would fully support the Commission's taking the
5 ample -- the time that's necessary to allow for a deliberate
6 decision, and thus giving the Joint Board opportunity to
7 give feedback to the Commission on the various complicated
8 proposals that are before it.

9 CHAIRMAN KENNARD: Let's hear from Sprint on this,
10 as well, from Mr. Sichter.

11 MR. SICHTER: Obviously, it's more important to do
12 it right and do it right the first time, than do it quickly.
13 We would support a limited extension till July of next year,
14 an additional six months, simply because, you know, at this
15 point, nobody can do any quantification because we don't
16 have the models finished. We don't have the inputs
17 finished. And that's only the beginning of that process of
18 doing the tweaks to really size the fund. The time is very
19 short.

20 On the other hand, I would remind the Commission
21 and the state members that, universal service fund is an
22 important, critical element in the development of local
23 competition. We've got to fix the economics of entry into
24 the local network. And a six month delay in revising that
25 system is a six month delay in creating the conditions that

1 we need to create for the introduction of local competition.

2 But given that, we've got to do it right when we
3 do it the first time. And let's get on with it and get it
4 done by July of next year at the latest.

5 CHAIRMAN KENNARD: Would any of our state
6 colleagues like to address this question?

7 MS. JOHNSON: I can address it and I guess it
8 addressed in my opening remarks. I do believe that the
9 deliberative process is necessary, that the Joint Board --
10 the state commissioners and the public advocate that we have
11 a lot to contribute to the process. I'd like to see the
12 process unfold in a very formal manner to allow more of this
13 dialogue, debate, even a written recommended order that
14 would allow those FCC Commissioners that are not on the
15 Joint Board, an opportunity to be full participants and
16 reflect on whatever might be recommended.

17 So, to the extent that -- and I understood, too,
18 that the Joint Board process is a cumbersome process. And
19 that it will take additional time. But at least, in my
20 personal view, to have the opportunity to have the
21 collective thought and the debate and the discussion with
22 the state members and the state advocate is not only the
23 best way to proceed, but it is consistent and proper under
24 the Act.

25 CHAIRMAN KENNARD: Yes?

1 MS. SCHOENFELDER: I would just like to add that I
2 really, really feel that referral to the Joint Board would
3 be beneficial to everyone. And let me tell you why.
4 Because as I sat here today and I go back a year and a half
5 or almost two years to where we started to hear this debate
6 originally, there have been -- a lot of us have learned a
7 lot, on this side of the table, as well as on that side of
8 the table. And I can tell you that there's some positions
9 on that table that have changed at least 180 degrees. And
10 some of them -- and I compliment you for that.

11 I also believe that by referring it to the Joint
12 Board, that I honestly do not believe anyone will be harmed.
13 We're not talking about suspending or taking away the support
14 for the rural companies out there that now exist in
15 extremely high cost areas. I don't see consumers being
16 harmed, which is my first criteria.

17 Secondly, even though Mr. Brown thinks that we
18 should hurry along, I happen to come from a U.S. West state,
19 and the RBOC in that state -- U.S. West in that state, does
20 not receive any cost funds now. I would tell you that we
21 would not allow them to let anybody fall off the system.
22 And I'm a state regulator, and believe me, I'm not going to
23 let you, Mr. Brown.

24 So, at this point in time, I believe everyone
25 would benefit from the continued deliberation and from the

1 continued input. This isn't an easy business. It's not an
2 easy business for regulators or for some of you to
3 understand. And we're in a changing -- it's important to
4 get it right.

5 I think Commissioner Powell told me that the first
6 time I visited with him, it's more important to get it right
7 than to do it quickly. And I will guarantee you that we
8 will move as quickly as we possibly can and still try to get
9 it as right as possible.

10 CHAIRMAN KENNARD: Thank you. If there aren't any
11 further comments from our side, I'd like to wrap up given
12 the time. Any other comments? Hearing none -- Chairman
13 Wood?

14 MR. WOOD: As one from a state who hopes to get
15 competition on the sooner rather than the later end, I do
16 think the gentleman from Sprint made some good points about
17 the need to get the structure in place as soon as possible
18 so that the defensive part of the frame can be in place.
19 So, I would maybe urge that the state board, if you all move
20 ahead, that the Joint Board do as soon as possible, get
21 together and move forward on some of these things. That
22 would keep the heat on the model developers very hot to get
23 that wrapped up.

24 Again, the B minus is got to be the standard for
25 us. It's a defensive fund we're talking about at this stage

1 of the game. And that we try to get back in that, maybe
2 rather than assume it's going to be July, say it's no later
3 than July. But as soon as we can get our work done from the
4 Joint Board part up here, than we can get it back to you
5 all. And hopefully -- and Joel, you're in charge of that,
6 so I'll leave that up to you.

7 CHAIRMAN KENNARD: That's very helpful. Hearing
8 no further comments, I think, I would like to echo comments
9 of a number of my colleagues today, to compliment this
10 panel. You've done a terrific job and have really shed some
11 light on some very difficult issues. And the proposals that
12 you described today are very thoughtful, and I know a lot of
13 work went into them, and we're very grateful to that,
14 particularly to you, Mr. Lubin. You certainly earned your
15 pay today, on behalf of AT&T. And I thank you for being a
16 good sport here today.

17 I'd also like to thank a number of people who
18 helped put this program together today. Chuck Keller, Jane
19 Wong, Martha Contee, Jeff Rudin, Cheryl Todd, Emily Hofner,
20 Craig Brown, Lisa Gelb, and of course, Jim Schlichting from
21 the Common Carrier Bureau.

22 And I look at this as sort of the end of the
23 beginning. We've got a lot of work to do. I think we, by
24 the spirit of our discussion today -- I think we've
25 recommitted to making sure that we can work together to get

1 these very difficult and vexing problems solved. They are
2 not easy. I think that the little skirmish that we're
3 seeing over schools and libraries foreshadows a lot of the
4 difficulties that we're going to see as we move to resolve
5 the high cost fund. In order to get through this, we're all
6 going to have roll up our sleeves and really work together
7 to make this happen.

8 Thank you all very much.

9 (Whereupon, at 4:54 p.m., the meeting was
10 concluded.)

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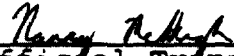
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